Nigerian Pension Reform 2004-2010: Great Leap or Inappropriate Policy Design?

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Jörg Michael Dostal**

Abstract: This paper analyses early results of the 2004 Nigerian pension reform. At the beginning of 2010, the new system of privately managed, funded pension accounts covered around four million Nigerians in a country with a workforce of around 50 million people. The study focuses on shortcomings of the new system. Most crucially, the reform has failed to contribute to basic social security in old age for the majority of Nigerians employed in the informal sector. Moreover, the minority of covered workers are also likely to experience problems. The study demonstrates in a model calculation that the funded accounts have so far produced negative real returns for pension savers. It is suggested that shortcomings of the current system are unlikely to be addressed by reform within the existing paradigm and that alternative policies, such as non-contributory universal social pensions, should be considered to expand basic social security in the Nigerian context.

Keywords: basic social security agenda, Nigeria, pension reform, social pensions

INTRODUCTION

The question of how to use social policies to link successful economic development with effective poverty reduction is at the core of contemporary political debate.

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One particular feature of this debate is the focus on policy learning and policy transfer in the context of comparative country studies. An important starting point is that policy learning is most appropriate for countries that share certain regime characteristics, or at least display similar levels of economic development. It is therefore problematic to compare developing countries with more advanced transition countries or countries that are members of the OECD (Organisation for Economic Co-operation and Development), and drawing lessons across the divide might be difficult or simply inappropriate (Barr and Diamond 2009, 18, 24-26; Kpessa 2010). Nevertheless, analysts and policy-makers frequently focus on countries that appear to have made transitions between developmental stages.

The current paper focuses on one such case: the 2004 Nigerian pension reform. This reform was inspired by the experience of Chile, an economically more advanced country, whose 1981 pension reform Nigerian policy-makers attempted to replicate (Orifowomo 2006; Casey and Dostal 2008). Nigerian policy-makers believed that the reform undertaken in Chile—the shift from a public defined-benefit (DB) system to a private system of individual funded accounts along the lines of defined contributions (DC)—would make it possible to address economic development and social security objectives at the same time. This study argues, however, that Nigerian policy-makers learned inappropriate and dated lessons from Chile. In addition, it will be shown that Nigeria lacks the necessary preconditions for a system of funded pension accounts to work in the long run, in particular developed and well-regulated capital markets that could assimilate pension savings. The paper then suggests appropriate policy alternatives for Nigeria, namely to refocus pension policy on basic social objectives in order to expand pension coverage through non-contributory social pensions. Although it does not offer a blueprint for Nigerian social pension policies, it makes the case for them to be developed in the near future to serve as an alternative to the current system, which is likely to remain unsuccessful on both economic and social grounds.

The subsequent argument is divided into five sections. The first section briefly sketches the outcome of the 1981 Chilean pension reform that served as a model to be copied in Nigeria. The second section explains the preparation and introduction of Nigerian pension reform. The third section analyses the debate about funded pensions, capital market development, and economic growth as far as it is applicable to the Nigerian case. The fourth section examines the potential of universal social pensions to alleviate poverty in low- and low-to-middle-income countries with major relevance for Nigeria. The fifth section provides an empirical account of the first six years of Nigerian pension reform (from mid-2004 to mid-2010) based on the relevant available open sources. A brief conclusion sums up the argument.

THE CHILEAN MODEL OF PENSION REFORM

During the 1990s, the 1981 Chilean pension reform—which involved replacing an earlier pay-as-you-go (PAYGO) and public pension system with a new compulsory system of individual funded and privately managed pension accounts based on defined-contribution principles—has been credited with linking old age social security with the facilitation of macroeconomic growth. World Bank personnel in particular suggested that the Chilean case proved that a shift of pension provisions from the public to the private sector and from pay-as-you-go to defined contributions would maintain social protection while increasing economic growth via the deepening of financial markets (World Bank 1994, 212-13).

However, the World Bank's earlier advocacy of private funded pensions has now lost its appeal for a number of reasons. First, the Chilean reform proved to be much less successful than was originally assumed. Although the Chilean system succeeded in making a large share of workers formally subscribe to individual funded pension accounts, the level and length of contributions and subsequent expected pension payments remained on average quite low. In fact, the system delivered poverty pensions rather than old age security to most contributors. In reaction to the coverage gaps of the funded system, the former center-left Chilean government decided to phase in a new public and tax-financed basic social pension system (*Pensión Básica Solidaria*) in order to provide additional income for current and future pensioners with very small funded pensions (Riesco 2009).

Second, claims about the contribution of Chilean pension funds to macroeconomic growth have also become more modest over time. Commentators instead have emphasized that the regulatory environment in which pension funds operate provides the most crucial variable to explain macroeconomic success or failure (Davis 1995, ch. 11; Barr and Diamond 2008; Iglesias 2009). Third, later stages of the Chilean reform demonstrated that high transition costs in paying for the winding down of the pre-1981 pay-as-you-go system, currently more than 40 percent of the Chilean government social budget, worked to crowd out other social spending. Hence Illanes and Riesco concluded:

> The Chilean pension system is not really a privately administrated, individual account based, fixed contribution, etc. system, but a mixed, public-private system instead. A major part of the workforce depends today, and will rely in the future, on the non-contributory, State financed, public pension pillar of the system, for the major part of their pensions (Illanes and Riesco 2007, 668).[1]

1. For additional discussion, see pages 649-51 and 666-69 in the same volume.

In sum, and pointing toward lessons beyond the case of Chile, analyses of funded pension systems have suffered because they evaluated the systems in isolation from economic and social contexts. Measuring the fairness of a funded pension system—by the extent to which it directly links contributions with benefits—ignores insurance and redistributive goals that tend to re-emerge on the policy-making agenda once the extreme inequalities of that approach become salient:

> There is no efficiency gain from designing one part of the system without distortions if distortions are then placed elsewhere to accomplish insurance and redistributive goals . . . even if the change leaves one part with no deviation from actuarial principles. . . . A pension system that includes poverty relief will be distorting; minimizing distortions implies minimizing poverty relief (Barr and Diamond 2009, 7, 13).

In the context of policy learning, it is significant that a recent change to the Chilean pension model, namely the introduction of the basic social pension, has so far not featured in the Nigerian debate. A case in point was a conference on pension reform in the Nigerian capital in May 2009 that was organized to draw lessons from the first five years of reform. The organizers invited a former director of the Chilean Pension Fund regulatory body to address the meeting, but this retired official only mentioned the latest Chilean policy changes in passing and did not focus on their potential relevance for Nigeria (Del Campo 2009). The remainder of this paper will argue that Nigeria should learn relevant lessons from Chile and other countries with established or emerging basic social pension systems, rather than trying to leapfrog between developmental stages in social and economic policy-making.

PENSION REFORM IN NIGERIA

As in other countries of sub-Saharan Africa, pension issues in Nigeria have a fairly limited relevance for the country's social protection system. The demographic profile of the population is weighted toward young people and older people mostly rely on informal provisions for survival in old age. Formal social security, including pension provision, is limited to the formal sector of employment, such as the civil service in each of the three levels of government (federal, state, and local), the military, and public enterprises (parastatals). In spite of low coverage rates in relation to the overall size of the Nigerian workforce, many pension systems existed in parallel before the 2004 reform. There were special schemes for public servants of the Nigerian federation, the (federal) police, security services, and the military. In addition, each of the 36 states, plus the capital territory, had a separate pension scheme for its public servants, as did each of the 774 local government authorities. These public sector pension schemes were non-contributory and unfunded (Casey and Dostal 2008, 244).

By contrast, before the 2004 reform, the formal private sector was covered by a pay-as-you-go pension scheme, the Nigerian Social Insurance and Trust Fund (NSITF). However, its scope and coverage were more limited than those of public-sector schemes. Only some larger enterprises offered access to the scheme and, since its foundation in 1994, the NSITF's accumulated capital and pension payouts were low while administrative costs were high (ILO 2006). The resulting pattern of pension provisions was highly fragmented, and the available data suggest that only 10 percent of the Nigerian workforce (about 4.8 million out of about 48 million) belonged to the formal employment sector, out of which about 3.7 million also belonged to a pension scheme (Casey and Dostal 2008, 245).

The 2004 pension reform did not significantly expand the scope of pension provisions in comparison to the pre-reform period. Although data on pensions under the old systems and the new system are difficult to compare, it took until the first quarter of 2010 to register 4.1 million subscribers to the new system of retirement savings accounts, which was only slightly above the pre-reform level, although the Nigerian workforce had expanded (Pension Commission 2010). This slow growth in coverage was partly due to the reluctance of private-sector employers to join the new scheme. Another significant factor was that state and local legislatures were hesitant to emulate the federal legislation for pension reform, and most of the 36 Nigerian states still do not comply with the provisions of the new system.

Shortcomings of the pre-2004 Nigerian pension systems, such as the existence of large-scale unfunded entitlements under the defined-benefit pension scheme for civil servants, matched by large-scale arrears of pension payments in all sectors of the system, were one reason the reform was undertaken. However, the more prominent line of reasoning was that pension reform should allow Nigeria to follow the Chilean model of providing long-term capital to develop financial markets and improve economic growth.

This reasoning is clear from a number of high-profile reports issued by subsequent Nigerian governments. Mention of the main features of the 2004 pension reform project can be found as early as 1997 in the Vision 2010 document of the then military government. It stated that "by the year 2010 most Nigerians shall have access to some form of social protection offered by the formal Social Security Program" (Pension Subcommittee 1997, 45). After the military regime gave up power and a civilian government was elected in 1999, the new administration put forward its own program for economic and political renewal, termed the National Economic Empowerment and

Development Strategy (NEEDS). This document referred only in passing to pension reform but reiterated the view that the reform might help to develop Nigerian capital markets (Nigerian National Planning Commission 2004, 114). Another characteristic statement from the same period suggests that pension reform

> has created a platform for the realization of all other reform programs of the Federal Government of Nigeria. Without long term funds, there can be no significant development in the much needed . . . sectors that would promote economic growth. In the short term, the regulations [on pension reform] seek to point to the need for the proactive and rapid development of the capital market through the creation of quality investment outlets for different asset classes to absorb these long term funds being accumulated for the first time in the financial history of Nigeria (Henshaw 2006, 7-8).

However, international financial institutions such as the International Monetary Fund (IMF) and the World Bank did not offer any significant support for the country's pension reform. The Fund engaged in two technical assistance missions to estimate pension arrears of the pre-reform pension system in the context of a "policy support instrument" but offered no direct financial assistance. The Bank originally offered Nigeria a technical assistance program to improve economic reform and governance in general, which included funding for a pension reform component. This funding was not paid out, but was subsequently shifted to address Nigerian aviation safety (World Bank 2009).

One might detect three main explanations for the decision to enact the 2004 pension reform: (1) unfunded pension promises under the pre-reform defined-benefit system for civil servants resulted in quickly growing pension entitlements that the government was unable or unwilling to fund; (2) the example of Chile suggested that pension reform might significantly improve the functioning of Nigerian financial markets; and (3) the government hoped that pension reform would add to the credibility of the general economic reform effort, since funding pensions would help to put the Nigerian federal budget on a fiscally sustainable footing (IMF 2005, 66).

As far as the first objective of pension financing is concerned, the reform required civil servants and public-sector employees to contribute to the system for the first time, withholding 7.5 percent of salary (an amount matched by the employer), while the contributions of private-sector workers, which were previously collected by the NSITF, were raised from 3.5 percent to 7.5 percent. The contributions of private-sector employers were increased in parallel from 6 percent to 7.5 percent. Members of the armed forces were exempted from this funding formula: they must contribute only 2.5 percent, while 12.5 percent is contributed on their behalf by the government.[2]

The management and investment of contributions is conducted by pension fund administrators (PFAs), while the money is held in trust by pension fund custodians (PFCs), both in accordance with the Chilean model.[3] The system is regulated by the Nigerian Pension Commission (PenCom), which mirrors the Chilean regulatory body (the Superintendency) and is responsible for approving PFAs and PFCs and for setting rules governing investment portfolios.

Under the new system, the replacement rate of future pension benefits in relation to wages is uncertain. Some simulation exercises by IMF and World Bank suggest that the replacement rate will be about 40 percent of final wages or salary in the case of a 30-year contribution record—much lower than under the former public- and private-sector schemes, which admittedly often went unpaid (Casey and Dostal 2008, 249). Other problematic features of the new system concern the decision to make low-wage earners pay full contribution rates and the failure to clarify the value and financing of a minimum pension, which the Pension Reform Act of 2004 (National Assembly of the Federal Republic of Nigeria 2004) provides for but which still remained undefined in 2010. In addition, the authorities at all levels of the Nigerian state have failed to deal with existing pension arrears deriving from the earlier pension systems, which are believed to have reached record highs in 2009 (Nzeshi 2009).

Following elections in 2007, the current Nigerian government engaged in a plethora of new policy initiatives to expand the earlier National Economic Empowerment and Development Strategy agenda.[4] Most significantly, the government put forward a new policy-making framework called Vision 2020 that, just like Vision 2010 (proposed in 1997), was based on analysis of the major subsectors of the Nigerian economy. A number of the 25 working reports informing Vision 2020 did make reference to pension

2. The Nigerian parliament recently considered proposals to exclude members of the Nigerian armed forces from the scope of the 2004 Pension Reform Act and to set up a separate scheme for military personnel (Tsan 2010).
3. An exception to the World Bank's hesitation to endorse Nigeria's reform is a report describing the Pension Reform Act as "basically sound in terms of the transparency and accountability of pension fund operations" (World Bank 2007, 43). However, this could be read as a defense of the original Chilean blueprint. The report noted on the same page that expected collections for the new Nigerian pension system should be much higher than was actually the case and that "reasons for this discrepancy are unclear."
4. In addition to Vision 2020, which aspires to turn Nigeria into one of the "20 largest economies in the world" by 2020, these initiatives concern a seven-point presidential agenda, a National Economic Empowerment and Development Strategy II agenda, and the Commerce 44 agenda on turning 44 Nigerian non-oil goods into export commodities (Orakwue 2009, ch. 4).

reform in passing, and one—the document on finance—offered for the first time some analysis of the outcome of the reform efforts to date (Nigerian National Planning Commission 2009). However, pension reform was downgraded in the new government's discourse, and emphasis shifted toward other issues, such as efforts to develop Nigerian export industries. Shortly thereafter, crisis management was forced upon the financial sector, as the country's stock market crashed in 2008 and the banking sector faced large-scale instability in 2009. The following sections examine the debate on funded pensions in Nigeria, the potential or otherwise of social pensions to offer an alternative to the funded system in the Nigerian context, and the first six years of practical experience with pension reform.

FUNDED PENSIONS IN THE NIGERIAN POLITICAL ECONOMY

In the Nigerian case, analysis of how compulsory individual funded pensions might affect national savings levels and economic growth must be read against conventional wisdom. This is necessary in at least two respects. First, increased savings rates might not be desirable in a very poor country. Given the lack of basic social security in the present, forced saving for the future might not be rational or desirable either for individuals or for society at large. Using funded pensions to develop the Nigerian financial market to provide long-term funding for productive investment and higher growth in the future is an experiment rather than a precondition for development in the present.

The most urgent issue in terms of how to accumulate resources for future development is to address the failure of the country's political and economic power holders to turn resource endowments into developmental gain for ordinary Nigerians. Short-term improvements in basic services and in creating preconditions for future economic development, such as the provision of electricity and treated water, might be available in a direct manner rather than through the detour of developing Nigerian capital markets. Some countries, such as China, might provide infrastructure in exchange for oil, and basic social security could be financed from outside at limited cost by rich donor countries (Clunies-Ross and Huq 2009).

Second, even if increased national savings and more developed capital markets were desirable in Nigeria, the existing scholarship on funded pensions points toward various barriers to achieving these objectives in low-income countries. Thus, it must be stressed that the academic literature does not offer support for funded pensions in the context of developing countries with a GDP as low as Nigeria's (Davis 1995, ch. 11; Barr and Diamond 2008, 94-110, 159-73; Barr and Diamond 2009, 24-25).[5] The literature suggests a very close link between GDP per capita and the development of financial markets. It is held to be impossible to skip stages in the build-up of regulatory capabilities, and financial market development must be advanced enough to allow for funded pensions to contribute to the system.

On the other hand, some authors have also pointed to the potential of contractual savings, such as funded pensions, to be more beneficial in developing rather than developed countries (Davis and Hu 2006, 206). However, this literature uses the term "developing countries" for countries that are more advanced than Nigeria, and the sample is too limited to allow for any generalization (Catalan et al. 2000, 28-30).[6] Thus, if regulation is poor and promising investment opportunities are limited, enforced long-term saving might fail to develop financial markets.

In addition, contributions to individual funded accounts can affect national savings and the rate of growth in different ways. They do not need to increase (and might even decrease) national savings if assets are primarily invested in newly created government bonds. Placing these bonds into individual accounts only increases public debt. On the other hand, savings might increase if existing bonds are purchased from the public (the difference between "narrow" and "broad" funding) (Holzmann and Hinz 2005, 93; Barr and Diamond 2008, 95-97).

In the Nigerian context, one can expect a mismatch between the accumulation of pension savings and the failure to find appropriate investment outlets that would produce real returns to pension savers. Some of the relevant problems with the funded pension system in the Nigerian context are outlined in table 1.

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5. Due to higher oil prices, Nigeria has been classified by the World Bank as a lower-middle-income country rather than a low-income country. However, a large gap in development continues to exist between Nigeria and countries with a more developed financial market (such as South Africa).
6. For example, in their frequently quoted study, Catalan et al. acknowledged that their sample of developing countries consisted of only three cases including Chile, and that the other two (Malaysia and Singapore) "exhibit little if any causality between institutions and markets" (Catalan et al. 2000, 29).

Table 1. Selected Problems of Nigerian Funded Pensions

Problem	Applicable to Nigeria?	Feedback from practical experience 2004-2010
Problems affecting institutions		
Pension authority's limited regulatory capability	Yes	Doubt was expressed by observers.
Poor data gathering and management	Yes	Doubt was expressed by observers.
Instability of the banking system	Yes	There was a large-scale crisis in the Nigerian banking sector in 2009.
Political interference with investment decisions	Possibly	The president's "seven points" suggested using pension savings for house building.
Limit in the number of asset classes available for investment	Yes	Pension regulators' guidelines limit investment to domestic government and bank money instruments and some domestic equity.
High transition costs in moving from old unfunded defined-benefit system and pay-as-you-go system (NSITF) to funded pensions	Yes	Pension arrears of pre-2004 unfunded public sector defined-benefit schemes reached record levels in 2009. Additional costs arose from transferring existing NSITF pension claims into the new system.
Problems affecting individual savers		
Doubtful credibility of future pension promises	Yes	Large-scale efforts to avoid contributions by workers and employers were reported.
Inadequate returns on low-yielding assets	Possibly	Very limited reliable data are available, but a small (less than 20 percent) equity share of investment is said to have contributed 50 percent of overall returns until the 2008 Nigerian stock market crash.
Returns threatened by high management charges	Yes	Charges levied by pension fund administrators, pension fund custodians and the Pension Commission were very high by international standards; they were reduced from 3 percent to 2.25 percent in the second quarter of 2009.
Returns threatened by high rate of inflation	Possibly	The average consumer price inflation between 2004 and 2009 was 11.7 percent per year.
Frequent change in labor market status questions build-up of significant sums in individual accounts	Yes	Nigerian data point to frequent changes in labor market status between the formal and informal sectors.

Notes: For column one, see Davis 1995, Davis and Hu 2006, and Barr and Diamond 2008. For columns two and three, see further references in the sections below. For the Nigerian annual inflation rate, see IMF data quoted at: http://www.indexmundi.com/nigeria/inflation_rate_(consumer_prices).html; for data on pension account charges, see http://www.ibtcpension.com/pn/200906.pdf.

The inherent problems of introducing funded pension systems and the recent changes in Chile both suggest that potential alternatives should be examined. Therefore, the next section focuses on the case of non-contributory social pensions as a potential policy-making alternative for Nigeria.

NIGERIA AND THE GLOBAL DEBATE ON SOCIAL PENSIONS

Over the last ten years or so, agendas of basic social security have increasingly influenced international organizations and global debates on economic development. Advocacy for basic social security—with social pensions as one potential policy instrument—originated in the International Labour Organization (ILO) and later influenced the IMF, OECD, United Nations Development Programme, World Bank and European Bank for Reconstruction and Development (Toye and Toye 2005, 7-9; Standing 2008, 19-21). In 2009, the ILO and other UN agencies launched a campaign known as Initiative VI, demanding a “social protection floor” defined as “a set of basic social rights, services and facilities that the global citizen should enjoy” (ILO 2010). The campaign responded to the current global economic crisis and has covered aspects such as normative issues, the building of state capabilities, and empirical modeling of expected costs of basic social security in different developing countries.[7] Due to extensive traffic in expertise and personnel between different international organizations, these ideas have become broadly accepted, although implementation, where it exists, appears to have preceded the recent debate.

One should note that basic social security agendas pursue growth and competitiveness by focusing on the question of how very poor people can start participating in markets in the first place. In other words, these policies might help to expand the scope of the global market economy by addressing some of the social deprivation that is linked with the breakup of earlier forms of social reproduction. The provision of basic social security in low-income countries is thereby understood to exercise an immediate effect on the political economy by adding to state stability and legitimacy. Such policies serve to encourage developing countries to provide social services and infrastructure in order to create “the right environment for entrepreneurial activity to flourish” (Nicholas Stern, quoted in Cammack 2006, 334).

In marked contrast to Chile’s role in the debate on funded pensions in the 1990s, no model country for the provision of basic social security has emerged. The most obvious candidate to serve as such a model would be South Africa, since social pensions,

7. For additional information, see the ILO Web site. http://www.socialsecurityextension.org.

together with other basic social security policies, have been made available to most of the country's pensioners. However, South Africa is a poor model in the current context since the country's extremely high Gini index of 57.8, as compared to Nigeria's 42.9, makes it one of the most unequal societies in the world (World Bank 2010).[8] In addition, during the last stages of the apartheid regime, the country shifted its former pay-as-you-go public sector pension scheme to full funding, thereby triggering high transition costs and an explosion of state debt, in which most of the pension savings are invested (Hendricks 2008, 6, 17-20).[9]

Yet the absence of a model has not stopped advocates of basic social security from addressing a large variety of potential applications and country cases. In the case of social pensions, defined as pure cash transfers to old people in which "eligibility criteria do not include a history of earmarked contributions having been made by the individual in question" (Palacios and Sluchynsky 2006, 8), the main issue is the scope of provisions and affordability issues. This concerns the relationship between social pensions and the broader social security system (if the latter exists), the relative contribution of social pensions to household income levels as opposed to other sources of income, and the size of the social pension in relation to average earnings. In this context, a number of developing and transition countries can be identified in which social pensions contribute significantly to the income of older people (Palacios and Sluchynsky 2006, 10). However, these countries—South Africa, Mauritius, Namibia, Botswana, Brazil and Bolivia—all exhibit levels of development, as measured in GDP per capita based on purchasing power parity (PPP), at least twice as high as Nigeria's.[10]

This casts some doubt on the potential of a social pension policy in the Nigerian case and leads back to questions of affordability and policy design. First, judgment on affordability depends on assumptions about the level of benefits granted, such as universalism of entitlement versus targeting and whether or not social pensions should be packaged with additional social policies. Most studies assume that social pensions should be part of a package of basic social security together with child benefits, disability pensions, and basic health care. They also assume that developing countries

8. The World Bank's Gini index is based on national data from South Africa (2000) and Nigeria (2004).
9. In fact, South Africa might serve as a negative model, since its spending share on social pensions is very small in comparison to the costs of its transition to full funding.
10. The country closest to Nigeria in terms of GDP (PPP) per capita, according to the latest available figures (IMF World Economic Outlook Database, April 2010, data for 2009), is Bolivia ($4,455, compared to Nigeria's $2,249). The average GDP (PPP) per capita of the group of six developing and transition countries with large-scale social pensions was $9,724, more than four times as high as Nigeria's.

would be assisted in their financing of provisions by OECD donor countries willing to redirect and increase their spending on aid (ILO 2008).[11]

Nevertheless, initial country conditions and administrative capabilities will determine the potential of social pensions to contribute to social security. For example, one of the rare estimates of potential costs of social redistribution focusing on Nigeria posed the question how much the richest fifth of the population would have to contribute in taxes as a proportion of their disposable income to move all Nigerians above a one- or two-dollar income threshold. It has been suggested that costs would be exceptionally high in comparison to all other countries under review for the one-dollar threshold and would demand the virtual appropriation of all disposable income of the richest fifth to meet the two-dollar threshold (Clunies-Ross and Huq 2009). In addition, attempts to limit expenditure by targeting social pensions in a non-universal manner would result in very high administrative costs relative to overall spending levels (Behrendt and Hagemejer 2009, 106).[12] Thus, the issue of funding remains paramount in assessing the viability of introducing social pensions.

In the Nigerian case, it also is appropriate to ask about the role of sequencing in the expansion of social policies. The Vision 2010 document referred to above, for example, suggested that Nigeria should be able to provide some form of formal social security to the majority of its citizens by 2010 (Pension Subcommittee 1997). It is obvious that this target has been missed; more importantly, there has not even been a move in the right direction. As for pensions, the share of workers covered has not been expanded by the 2004 reform and might have declined further. The reformed system continues to exclude the poor and workers in the informal sector. Furthermore, federal, state,

11. At present, ILO costing studies exist for seven African and five Asian developing countries. However, the current author and two ILO experts could not identify any costed studies for the case of Nigeria (personal communication, August 27 and 29, 2009). A recent World Bank study of social pensions also does not cover the Nigerian case (Holzmann et al. 2009).

12. In particular, assumptions about how to procure funding for basic social security might be more problematic for certain countries. For the case of universal social and disability pensions, ILO studies assume that the level would be set at 30 percent of GDP per capita, with a maximum of one dollar (PPP) per day as a cut-off point (ILO 2008). This suggests very high costs in countries like Nigeria, in which many people live below the one dollar (PPP) per day threshold, and in which wealth and the wealthy tend to exit the country. Thus, the financing problem in Nigeria is due to the fact that most of the domestic population lives below the one dollar threshold, and many of the better-off live not much above it. This explains the extraordinarily high cost estimates of Clunies-Ross and Huq (2009) for basic social security in the Nigerian case, which require further investigation.

and local government employees might see the high deductions from their salaries for the funded pension system as another tax and might resist the new system in various ways.

Social pensions, on the other hand, might be the only available policy instrument to increase formal social security in the short and medium term. They have been credited with effects such as improving women's health, supporting the rural poor, heightening the status of older people in the family, and increasing school enrolment (Johnson and Williamson 2006). However, social pensions also have some disadvantages. In the Nigerian case, social pensions would be reliant upon the same revenue base—oil rents distributed by the Nigerian federal government among the 36 states according to a constitutionally fixed funding formula—as the old, unfunded pension scheme. It would merely involve an alternate way of distributing government revenue, channeling it away from elites to broader sections of the population. Thus, the instability of the revenue source would remain and the danger of arrears in payments would not be removed. Moreover, the administrative capacity of state and local governments to establish eligibility for social pensions and to deliver such a system would be in doubt.

Nevertheless, social pensions do offer advantages not available through other policy choices. Distributing some of the revenue of Nigeria's oil wealth in an equal manner between richer and poorer states would help the federal government gain more legitimacy. In all likelihood, social pensions could constitute the next step in the country's evolution, while becoming the lowest-GDP-per-capita country on earth with a system of funded private pensions means entering uncharted territory.

THE FIRST SIX YEARS OF NIGERIAN PENSION REFORM

This section explores Nigeria's six years of practical reform experience since the passing of the federal Pension Reform Act in 2004 as follows: (1) a review of the debate on the outcome of pension reform within Nigeria; (2) a review of the role of PFAs; and (3) a survey of some features of the banking system, stock market, and other macroeconomic issues that might influence the funded pension system.[13]

The *outcome of pension reform* within Nigeria raises two main issues. On the one hand, the government and the Pension Commission (PenCom) have abandoned their earlier frequent references to the Chilean model. On the other hand, debate has

13. This paper does not provide an analysis of recent pension reform at the state and local levels. It might be assumed, however, that the experience at the federal level is likely to be replicated at lower levels of the Nigerian federation.

become focused on how the assembled pension savings might be used for productive investment. However, deliberation has so far failed to produce new insights to enable future action. Regarding the government's own assessment of pension reform, a conference in Abuja on May 19 and 20, 2009, demonstrated a lack of direction (Pension Commission 2009).

The last Nigerian president appears to have conceded the point that the funded pension system would need to be supplemented with unfunded social pensions to assist the large majority of Nigerian workers outside of the formal sector of employment.[14] According to one source, he told the Abuja conference that "Nigeria [needs] to consider a non-contributory pension scheme (social pension) currently being operated aside the new scheme for the purpose of addressing the problems facing it" (Global Action on Aging 2009).[15] However, the conference did not focus on the issue, and the parallel introduction of social pensions in Chile was not discussed. Instead, nearly all presentations concerned attempts to find alternative future investment opportunities, such as general comments about public-private partnerships, which appeared to lack relevance. The only clear point was a focus on using pension savings for future investment in housing, but it remained unclear why pension savings rather than direct government investment were needed.

Apart from the conference, debate about the new pension system was also taking place in the context of the president's "seven points," also known as the Nigeria Project Agenda, and in preparing the Agenda 2020. The seven points essentially recommended altering the investment guidelines for PFAs in favor of the real sector and low-cost housing schemes. The report presented Brazil and Jamaica as positive examples and criticized the existing investment guidelines as too narrow (Government of Nigeria 2008, 5, 36-37). However, this suggestion was quickly dropped and did not feature in subsequent government announcements. This left the Agenda 2020 working group on finance to express "concerns about [lack of] sufficient depth in the capital market to effectively absorb the available and expected pension funds without causing a glut and overvaluation of existing capital market securities" (Nigerian National Planning Commission 2009, 43-44; see also World Bank 2007, 43-44). The same group also stressed that high transaction costs could erode investment appreciation. As for solutions, the report was silent. The problem of lack of suitable investment outlets therefore remains the crucial policy-making dilemma (Stewart and Yermo 2009, 25).

14. President Umaru Yar'Adua, the 13th Nigerian head of state, died in office on May 5, 2010.
15. Another source suggested that the late president did not support social pensions but warned instead of corruption in unfunded schemes in general terms (Josiah 2009). A written record of the actual remarks made at the conference is not available.

In this context, analysis must now turn to *the role of the pension fund administrators (PFAs)* at the core of the funded pension system. Their ability to manage contributions over time in a manner that produces real returns to savers after inflation and deduction of management fees determines future pensioners' economic prospects. In the Nigerian regulatory system, PenCom issues guidelines on the maximum share of investment that PFAs are allowed to take out in different asset classes—government bonds, money market instruments issued by domestic banks, and selected domestic equities—and the pension fund custodian (PFC) holds savings on trust to separate asset holdings from the PFA's investment function. For their services, PenCom and the PFC each receive a share of the management fee, which used to amount overall to 3 percent and was cut to 2.25 percent in the second quarter of 2009. Currently, 1.6 percent goes to the PFA, 0.4 percent to the PFC, and 0.25 percent to PenCom.

Judging from the proliferation of PFAs since the start of the reform, management of Nigerian pension investments appears to be a good business proposition—at least as far as the PFAs themselves are concerned. Since an earlier survey on October 23, 2007 (Casey and Dostal 2008, 254), the number of PFAs has proliferated from 13 to 26, and the number of PFCs has increased from four to five (data from Pension Commission Web site, June 15, 2010). It is likely that the number of competing PFAs in the small Nigerian market (with around four million subscribers) is, in relative terms, the highest in the world.

In spite of the proliferation of PFAs, their competence must be questioned: they appear to fail to provide their customers clear information about their investment strategy. A survey of PFA Web sites conducted in September 2009 showed that many had not been updated for at least two years. Moreover, virtually all companies were in breach of PenCom guidelines to publish the rate of return of their Retirement Savings Account (RSA) funds at the end of each financial year and to make the unit prices of their RSA funds readily accessible online (Pension Commission n.d.a).[16] In fact, only 14 PFAs (out of 26) provided any information about the value of their respective RSA units on their Web sites (see table 2). Of these, seven offered out-of-date or undated unit prices that lacked informational value. Of the seven that provided more recent data, only three provided sufficient data to calculate approximate rates of return, and only a single PFA provided full coverage of the value of the company's RSA unit since its inception, which allowed calculating the actual rate of return. The silence on rates of return appears to be no coincidence; once inflation and management charges

16. The PenCom regulation states that the PFAs were supposed to publish RSA fund rates of return for the first time on December 31, 2007. Thus, it was issued either late in 2006 or in 2007 and has since been ignored.

are factored in, it appears to conceal negative returns. For the single case in which a PFA provided sufficient information, the real rate of return after inflation and charges between May 2, 2006, and September 2, 2009 can be calculated as negative. This is significant, since the company in question has been an acknowledged industry leader.[17]

Table 2. Information Provided Online by 26 Licensed Nigerian Pension Fund Administrators

Information*	Number of PFAs who provided it
Names of company personnel (management team and board of directors)	17
Ownership structure (shareholders) of the company	11
Current or recent (not older than one month) price of the RSA unit	7
Out-of-date or undated price of the RSA unit	7
Some long-term data to evaluate the development of the RSA unit over time	3
Complete set of long-term data to evaluate the development of the RSA unit over time that allows calculation of the rate of return after inflation	1
Complete set of long-term data to evaluate the development of the RSA unit over time that allows calculation of the rate of return after inflation and after deduction of management fees	0

Information was compiled during a survey of PFA Web sites on September 10-11, 2009.
* Of the 26 licensed PFAs, 25 had a Web site. Four of those Web sites were no longer functioning.

17. The PFA in question is run by IBTC, a South African bank, and received a prize from the Nigerian newspaper *This Day* as pension fund manager of the year for 2009. The company's RSA unit started on May 2, 2006 at 1,000 naira and on September 2, 2009 (40 months later) stood at 1,452 naira. A model calculation, assuming 11 percent consumer price inflation on average over the duration and an annual charge of 3 percent for the first three years and of 2.25 percent for the last four months, jointly levied by PFA, PFC and PenCom, suggests a figure of 1,546 naira would be needed to beat inflation and charges. (The last four months were calculated as a third of the above quoted annual figures—3.7 percent inflation and 0.7 percent charges.) According to these assumptions, the actual rate of return was negative once inflation and charges were factored in. It is possible that this calculation is still too optimistic, however, since even in the case of the "fund manager of the year," it is not clear from the available figures how charges were accounted for in the valuation of the RSA unit. Fees were also ignored in the only presentation on returns available on the PenCom Web site (Okpaise 2009). An additional problem for the purposes of comparison is that different PFAs started at different points in time to manage investments and their subsequent RSA unit prices are not comparable. In sum, all PFAs would have to give actual rates of return for each year, calculated as a share of a full business year in the case of the first year, in order to allow pension savers an informed choice between administrators.

According to plausible assumptions, one must conclude in the case of all six remaining PFAs with recent RSA unit figures that their returns have been negative and in at least two cases highly negative. Since seven other PFAs provided only out-of-date or undated figures (all pointing toward negative returns), and 12 provided no data at all, one needs to suppose that the only successful participants in the system of funded accounts are the PFA companies themselves. These estimates by this author would need to be verified by making all the necessary data available for all 26 licensed PFAs. However, PenCom has not acted to enforce its own regulations and, given its own lack of compliance with regular reporting of activities, might not be in a position to complain.[18]

The issue of how PFAs perform leads directly to the larger question of *how the banking system, stock market, and macroeconomic performance of the Nigerian economy might interact with the funded pension system.* Defenders of the current system would argue that it is too early to make any claims about the failure of funded pensions to have a positive impact on the economy. They would point to the global economic crisis and the 2008 crash of the Nigerian stock market as unexpected events that explain negative returns of PFAs but do not call into question the system's fundamental viability. Moreover, the biggest losses of pension and social security funds on a global scale have been sustained in OECD countries with highly developed financial markets, rather than in developing countries (International Social Security Association 2009).

Nevertheless, one must also account for the domestic aspects of the Nigerian crisis, as the country was once again unable to translate an unexpected hike in oil prices into convincing economic results. Under the pre-2007 government, oil revenue was shifted from the federal budget to an Excess Crude Account with unclear constitutional status and hazy lines of accountability (Akintunde 2008). This newly created account worked

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18. The first PenCom annual report, covering 2007 and published in late 2008 (Pension Commission n.d.b), did not provide any data on investment returns. As for investment policy, the data for retirement savings accounts suggest that 60 percent of savings were held in Federal Government of Nigeria securities and 21 percent in domestic money market instruments while equity investment was around 16 percent. The second annual report, covering 2008 and issued in late 2009 (Pension Commission n.d.c), stated figures for the three main asset categories of 56, 32 and 9 percent respectively. The 2008 report acknowledged overall negative returns and did not make any claims about positive results of pension savings for the real economy. In addition, the report underlined that 60 percent of Federal Government of Nigeria bonds (one zero is missing in the report's figure) are allotted to pension funds (Pension Commission n.d.c, 12-23). The language of the 2008 report suggested that the estimates of negative returns presented here might be too low. Moreover, before the 2008 Nigerian stock market crash, equities had produced half of all the portfolio's returns, pointing to very low or negative returns for the remainder (Rewane 2009, 4).

to strengthen the position of the president, as did the creation and subsequent high profile of the Economic and Financial Crimes Commission (EFCC), closely linked with the president's office, which assumed the role of control mechanism of last resort in the Nigerian polity. During the last oil boom, excess liquidity, the loose monetary policy of the Central Bank of Nigeria, and the increased credit creation of private banks prepared the scene for the subsequent crash. Excessive credit creation by private banks appears to have been used to drive up banks' own share prices and to provide extensive credit for oil companies, which could no longer be served once oil prices dropped again.

In the second half of 2009, the Nigerian financial system was held to be close to the breaking point due to nonperforming loans. On August 14, the new head of the Central Bank of Nigeria took the initiative to have the bank act as lender of last resort, providing a bailout of 400 billion naira (later 620 billion naira) to save five (later eight) of the 25 major Nigerian banks (Abubakar and Ekundayo 2009; Casey 2009; Komolafe 2010).[19] The top managers of the banks in question were subsequently arrested by the EFCC on 118 charges in "the biggest single arraignment made by the EFCC since its inception in 2003" (Media and Publicity Unit 2009). According to the pending charges, loans without adequate collateral of more than 700 billion naira had been made by the banks in question, which according to EFCC prosecutors amounted to "economic sabotage and threats to the economic health of the nation" (Media and Publicity Unit 2009). One of the accused top managers, who had only recently been elected as deputy chairman of the Nigerian Stock Exchange, managed to avoid arrest by leaving the country. He accused the governor of the Central Bank of Nigeria of settling old business conflicts by unleashing the EFCC against him, while other observers suggested that the affair had seriously damaged the business reputation of all Nigerian banks and challenged their viability (Aminu and Iriekpen 2009).

As far as the funded pension system is concerned, the lack of regulatory control of the financial markets might damage the interests of savers in a number of ways. First, the overall savings accumulated in contributions from workers and employers since 2006 amounted to 472 billion naira, according to PenCom (Alabadan 2009). This sum, roughly equivalent to the first Central Bank of Nigeria bailout of five banks, is principally invested in government securities, money market instruments of private banks, and, to a lesser extent, equities. In the case of a banking crisis, the safety of investments would be questioned, while the Nigerian Stock Exchange recorded drastic losses in comparison to its peak in 2008 (see table 3).

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19. According to a survey of Nigerian banks based on 2006 data, the eight institutions in question ranked 1, 4, 6, 14, 15, 18, 23, and 25, out of 25 surveyed institutions, in terms of their capital base (*Nigeria Banking Bulletin*, quoted in Becker et al. 2008, 20).

Table 3. Nigeria Stock Exchange All Share Index, January 2000-June 2010

	2000-2003	2004	2005	2006	2007	2008	2009	2010
Year high	21.147.24	30.703.46	26.221.90	35.068.84	57.990.22	66.771.20	31.357.24	28.029.78*
Year low	5.253.50	20.272.91	20.682.37	23.144.13	33.163.94	28.085.01	19.803.60	20.838.90†

Sources: O. Ogunyemi, Investment Analyst, available at: http://www.docstoc.com/docs/6764814/Technical-Review-of-The-Nigerian-Stock-Exchange-(All-Share-Index)-as-at-June-2-2009. Most recent data available at: http://www.proshareng.com.

* Figure given is as of April 19, 2010.

† Figure given is as of January 4, 2010.

Thus, the only "safe" investment class for the pension system consists of Nigerian federal government bonds. If government bonds produce returns that are higher than the rate of inflation and management fees combined, the interests of savers might be protected. If not, they are eroded by the shortfall. The outcome ultimately depends on the type of macroeconomic management adopted; the expansionary monetary policies in Nigeria cast doubt on the viability of this strategy. In fact, it is still the state's public debt policy that determines returns of the "private" pension system (Hermann 2009). This state of affairs points to structural problems with funded pensions in general that might also apply in more advanced economies.

CONCLUSION

None of the originally stated goals of the Nigerian pension reform have been achieved so far. First, Nigeria continues to carry significant pension arrears from the pre-2004 unfunded pension systems, and some sources suggest that unpaid pensions have reached record highs. Second, the post-2004 funded pension system has not had any significant impact on the development of Nigerian financial markets, since most of the assets are held in government securities and domestic bank money instruments. It is therefore funded only in the most narrow sense, due to a lack of other appropriate investment outlets. Thus, no shift of savings toward the real sector could be observed. (Indeed, the supporters of reform have not made any claims in this respect.) Third, Nigeria's macroeconomic credibility has declined. This was due to developments not causally related to pension reform, but rather to factors such as the volatility in world oil prices, the parceling off of oil income into special funds with unclear accountability, an unsound monetary and banking system, and the world economic crisis. Overall, the regulatory environment has failed to encourage interaction between pension reform and economic reform, while problems of regulation within the new system, such as the lack of transparency of PFAs about their investment returns and fees, have also called the credibility of the reform into question.

Most importantly, the 2004 reform has failed to allow for coverage of workers outside of the formal sector of employment. As it now stands, the funded pension system is isolated from larger social security concerns. It only caters to the needs of workers in the formal employment sector, and it does even that poorly. Policy-making efforts are now focused on finding long-term investment outlets for forced pension savings in financial markets that are not mature enough to absorb such funds. It is here that the costs of trying to copy the inappropriate Chilean pension model become most apparent.

In order to address the current shortcomings, a new direction in Nigerian policy-making regarding pensions would be necessary, changing the agenda toward basic social pensions to increase coverage rates and to introduce redistributive and solidarity features into the system. Such policies would have to be combined with broader basic social security objectives along the lines suggested by the ILO and other international bodies (Ehmke and Skaletz 2009). In addition, basic social security schemes in other sub-Saharan African countries, at stages of economic and social development similar to Nigeria's, would need to be studied in greater detail to draw relevant lessons. Such a new course would have immediate benefits, address the issue of economic development from the grass roots, and improve on the current promise of a "great leap" that is likely to remain a mirage.

The Nigerian case has largely been ignored in the analysis of global pension policy. It has hardly featured in the emerging discourse on the basic social security agenda. This is a critical shortcoming. Explaining how countries with multiple barriers to successful social development such as Nigeria could engage with a basic social security agenda—with social pensions as one core element—determines whether or not the agenda has any chance to influence future policy-making. Understanding that basic social security will not come about as a result of economic development at some future point, but rather is itself a necessary precondition for future economic development, as argued by the ILO, is therefore a crucial first step.

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